

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

|   |   |                  |
|---|---|------------------|
| In the Matter of the Protest of           | ) |                  |
|   | ) | DOCKET NO. 15253 |
| [Redacted],                               | ) |                  |
|   | ) | DECISION         |
| Petitioners.                              | ) |                  |
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[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditors for the Idaho State Tax Commission (Commission) dated November 3, 2000. The Notice of Deficiency Determination asserted additional liabilities of \$28,985 and \$2,774 for 1997 and 1998, respectively.

The petitioners were nonresidents of the state of Idaho. During the years here in question, they held interests in pass-through entities transacting business in the state of Idaho.

The auditor adjusted the amounts of income attributed to Idaho from an S corporation in which the petitioners owned an interest for both 1997 and 1998. He also included investment credit recapture relating to a pass-through entity.

The petitioners raised two questions. The first was to claim an Idaho capital loss carryforward for 1996 not claimed on their original 1996 Idaho income tax return. The other was to question the adjustment to the investment tax credit reflected on the Notice of Deficiency Determination.

The Idaho capital loss carryforward claimed was from the disposition of stock in 1996. The corporation, the stock of which was sold, was operating in Idaho.

Stock is an intangible. U.S. v. Anderson, 532 F.2d 1218, 1221 (CA9, 1976). Generally, the income or loss from the sale of intangible assets by an individual taxpayer is deemed to have its source in the state of the individual's domicile.

Idaho Code Section 63-3026A stated, in part (1996):

Income shall be considered derived from or relating to sources within Idaho when such income is attributable to or resulting from:

\* \* \*

(iii) The ownership or disposition of any interest in intangible personal property only to the extent that such property is employed in a business, trade, profession or occupation conducted or carried on in this state. Provided however, that interest income from an installment sale of real or tangible personal property shall constitute income from sources within this state to the extent that the property sold was located within this state. Provided further, that interest income received by a partner or shareholder of a partnership or S corporation from such partnership or S corporation shall constitute income from sources within this state to the extent that the partnership or S corporation is transacting business within this state;

The petitioners contend that the loss from the disposition of the stock had a source in the state of Idaho and that, therefore, the loss should be reflected as Idaho source income in the computation of Idaho taxable income. They contend that Administrative Rule 260.02.a provides the authority for the inclusion of the loss as Idaho source income. IDAPA 35.01.01.260.02.

Income Tax Administrative Rule (1997) read in pertinent part:

02. Income From Intangible Property. Generally, gross income from intangible property is sourced to the state of the owner's domicile. There are three (3) exceptions to this rule.

a. If the intangible property is utilized in connection with the owner's trade, business or profession carried on within Idaho, any income derived from or related to the property, including gains from the sale thereof, constitutes income from Idaho sources. For example, if a nonresident pledges stocks, bonds or other intangible personal property as security for the payment of indebtedness incurred in connection with the nonresident's Idaho business operations, the intangible property has an Idaho situs and the income derived therefrom constitutes Idaho source income. (Underlining added.)

The petitioners contend that they were required to be a co-borrower with the corporation essentially guaranteeing the operating loan for the corporation of which they sold the stock.

Since the general credit of the petitioners was liable for the debt, the stock was essentially pledged as security for the operating loan for the corporation and, therefore, falls within the bounds of Rule 260. Therefore, the petitioners contend, the loss is from an Idaho source.

The Commission finds two problems in the reasoning of the petitioners. First, the general credit of the petitioners is not synonymous with the pledging of a specific security. The Commission finds that the specific securities here in question were not involved, in any meaningful fashion, in a business in Idaho. Secondly, gain or loss from the disposition of an intangible may be, according to Rule 260, considered to be from an Idaho source if it is pledged as security for the payment of indebtedness incurred in connection with *the nonresident's Idaho business operations*. The *nonresident* and the corporation are two separate and distinct legal entities. Swope v. Swope, 112 Idaho 974, 981; 793 P.2d 273, 280 (1987). Even if it were to be found that the stock was pledged for the payment of the indebtedness of the corporation, it would not have been the business operation of the petitioners.

WHEREFORE, the Notice of Deficiency Determination dated November 3, 2000 is hereby APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax, penalty, and interest:

| YEAR | TAX      | PENALTY | INTEREST  | TOTAL           |
|------|----------|---------|-----------|-----------------|
| 1997 | \$22,177 | \$2,218 | \$5,252   | \$29,647        |
| 1998 | 2,456    | 0       | 392       | <u>2,848</u>    |
|      |          |         | TOTAL DUE | <u>\$32,495</u> |

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioners' right to appeal this decision is enclosed with this decision.

DATED this \_\_\_\_ day of \_\_\_\_\_, 2001.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2001, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED]                      Receipt No. [Redacted]  
[REDACTED]  
[REDACTED]

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ADMINISTRATIVE ASSISTANT 1